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8th February 2012

Dear Richard

Consultation: Periodic Review 2013 - Consultation on incentives

This letter is Arriva Trains Wales' response to ORR's December 2011 consultation document on incentives. We have focused on those issues most relevant to Arriva Trains Wales and the Wales & Borders franchise.

Understanding the PR13 objective

Arriva Trains Wales supports ORR's intention to more closely align incentives across Network Rail and operators, through increasing transparency on costs and from ORR's work on whole-industry costs and benchmarking costs between operators and Network Rail. We feel that there is still some way to go before these costs are fully understood, and there are other ongoing industry reforms that will have a bearing on ORR's proposals in the consultation document. Aligning incentives might be made easier should DfT choose to reduce the extent of protection provided to franchises against changes to Network Rail's access charges; this could be a positive move but ORR would need to consider the impact of PR13 on future franchises much more closely than it has to date.

ORR's desire to understand transmission mechanisms is welcomed and is clearly key to identifying ways to influence Network Rail's behaviours. Devolution will be an important enabler to help Network Rail work more closely with operators and through our alliancing

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work with Wales Route we are hoping to change some of Network Rail's processes in Wales. Much cross-industry work is also being coordinated by the Rail Delivery Group in which Arriva UK Trains is involved.

However there are still major gaps which manifest themselves in poor service from Network Rail to operators and their customers. In essence, Network Rail is still too distanced from the fare-paying customer and we are regularly frustrated by Network Rail's inability to appreciate the fundamental importance of this to us. Many areas in Network Rail's control, that impact on operators and their customers, are not areas that it is properly incentivised to maintain or improve. Three key issues for Arriva Trains Wales are maximising the use of capacity; improving journey times; and lessening the impact of possessions – none of which are strongly incentivised. Where incentives do exist, they are either weak, in conflict with each other or so easy for Network Rail to achieve as to render them meaningless to us.

Despite Network Rail's distance from our customers, we remain uncertain of the usefulness of measuring Network Rail against delivery of outcomes where they are beyond its control. We realise that a narrow focus on outputs can encourage perverse incentives: this is evident in Network Rail's increasingly cautious approach to timetabling which has probably reduced delays but at the risk of producing less optimal train paths. But a wider focus on delivery of outcomes that benefit customers, wider society and funders, will be much more difficult for Network Rail to properly react to in a targeted manner and difficult for ORR to measure. We believe that close working with Network Rail at a Route level will yield more positive results.

Aligning Network Rail and train operators' incentives to increase efficiency

Exposing operators to certain of Network Rail's costs in order to increase efficiency might have merit at franchise change for some franchises. We are broadly supportive of the concept of Route-level efficiency sharing: as proposed it could be a useful tool for the Wales & Borders franchise whose services are concentrated on the Wales Route and so would receive a comparatively greater return on its efforts to work with the Route.

We would be interested to understand more about the types of efficiencies that might be identified and how their success will be measured, and the possible dangers of perverse incentives being created.

Possessions and performance regimes

The primary purpose of Schedules 4 & 8 is as a compensatory mechanism which should reflect the true cost to the operator of being unable to deliver its base timetable, whether planned or unplanned. To that end, it is adequate and we strongly refute the suggestion that operators should be paid at a level below 100% compensation to encourage 'co-operation' between operators and Network Rail. We would suggest that this is incentivising the wrong party. Operators, Arriva Trains Wales in particular, already have every incentive to pursue performance improvements and to minimise possessions: franchise milestones for both PPM and delay minutes, PPM bonus/malus payments, reputational consequences of poor performance, customer relations costs, and even loss of franchise.

Possessions have a major impact on Arriva Trains Wales' services: with few diversionary options and long replacement bus journeys, the impact on our customers is significant. However the Schedule 4 payments are insignificant to Network Rail and do not incentivise it to make choices that are best for our customers. As an example, Network Rail is currently undertaking major renewals on the Cambrian mainline between Craven Arms and Welshpool. The cost of the work is approximately £7m; luckily it is beneficial for both Arriva Trains Wales and Network Rail for the work to be undertaken as a midweek night campaign over many weeks, with only marginal impact on Arriva Trains Wales's last services. This arrangement was made possible by a mutual understanding of our businesses at a local level; but if Network Rail had wanted to deliver the equivalent work conventionally, in 11 full weekend possessions, Schedule 4 would have not had any impact on Network Rail's decision to deliver the work in that way.

Network Rail is not incentivised to reduce the level of change it makes to possessions after they have been agreed. It qualifies for an early notification discount but there is no mechanism to discourage Network Rail from altering or cancelling possessions at any time (aside from its own wasted costs). Network Rail typically changes 30% of all disruptive possessions after they have been negotiated with us (30% in 2009; 27% in 2010; and 29% in 2011). Some of these alterations were at very short or no notice causing considerable misinformation and disruption to our customers.

We have no experience of the Sustained Poor Performance or Sustained Planned Disruption mechanisms as the thresholds are set too high to be of any meaningful use. At Route level, other incentives – whether regulated processes such as JPIPs and JNAPs or local initiatives – have a greater importance day-to-day.

Although Network Rail also has other incentivising mechanisms (PPM and threat of ORR intervention) they are not at the same level of ‘intensity’ of those experienced by operators and does not “drive their decision making”. The only other motivation for Network Rail that is on a par with Schedule 8 for its ability to motivate is the need to meet CP delay minute targets (again financially motivated). However, where Schedule 8 does not result in significant financial impact, it is rendered redundant. We would therefore agree that a potential way to overcome this could be to introduce a punitive element to the payments which, as ORR points out, would not necessarily need to be passed on to operators.

However, it must be noted that where operators have significant performance incentives tied to other measures, recourse must be available for acknowledging loss of such revenue due to Network Rail performance. We would therefore advocate that operators be permitted to withhold track access when performance is poor, through a liquidated sums regime.

Network Rail stated last July that “while its internal management structure is focussed more on meeting targets than the Schedule 8 performance regime, the impact on Schedule 8 payments is important when building business cases.” This merely emphasises the imbalance that Schedule 8 brings to some operators/Routes where the regime and the financial implications associated with it are not sufficient to build business cases and tackle significant issues, such as cable theft.

For the above reasons we would also be supportive in principle of bespoke performance regimes.

Capacity utilisation incentives

We strongly believe that capacity is not being used efficiently by Network Rail. There is little incentive for Network Rail to systematically review capacity and how to increase it. For

example, there are many timetabling rules that restrict what we can plan to do and can impact on our resources as a result.

Overall we are pleased that ORR recognises the incentive gap between Network Rail and operators and we agree that regulated outputs have an important role to play. But we remain of the view that the many industry reforms currently underway have considerable potential to more effectively align Network Rail's incentives, and to deliver improved efficiencies, to the benefit of the whole industry. ORR should ensure that its own PR13 workstreams fully engage with these reforms and that changes proposed by the review are wholly necessary.

Yours sincerely

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